

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE ADJUSTMENT OF RATES            )  
OF SHADY VILLA SEWER                ) CASE NO. 8717  
CONSTRUCTION DISTRICT               )

and

In the Matter of:

PUBLIC SERVICE COMMISSION        )  
VS. SHADY VILLA SEWER             ) CASE NO. 8816  
CONSTRUCTION DISTRICT             )

O R D E R

On November 1, 1982, Shady Villa Sewer Construction District ("Shady Villa") filed its application with this Commission to increase its rate pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). The proposed rate would produce additional revenue of \$70,599 annually, an increase of 131 percent. Based on the determination herein the revenues of Shady Villa will be increased by \$18,489 annually, an increase of 34 percent.

A hearing was held in the Commisison's offices in Frankfort, Kentucky, on May 19, 1983. A separate show cause proceeding followed the hearing for the purpose of determining if Shady Villa's rates should be reduced as a result of implementation of the annual assessment provided for in its bond resolution.

Motions to intervene were filed by Mr. Laurence J. Hackett, Ms. Nelle P. Horlander and the Ambassador Corporation, all consumers of Shady Villa.

#### COMMENTARY

Shady Villa is a non-profit sewer construction district organized and existing under the laws of the Commonwealth of Kentucky, and serving approximately 712 customers in Jefferson County.

#### TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to known and measurable changes found reasonable.

#### REVENUES AND EXPENSES

Shady Villa proposed several adjustments to its test period revenues and expenses. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with certain modifications. In addition the Commission has made several adjustments to Shady Villa's test period operating statement to reflect actual and anticipated operating conditions.

#### Operating Revenue

Shady Villa's income statement for the 12 months ended December 31, 1981, reflects total revenue of \$51,290. However, the billing analysis filed by Shady Villa for the calendar year 1981 reflects annual revenues of \$53,732. Therefore, the

Commission has determined that an adjustment should be made to increase operating revenue by \$2,442.

Repairs and Maintenance Expense

During the test year Shady Villa purchased two new electric blowers at a cost of \$4,246 and included this amount in operating expenses. Upon an analysis of these expenditures, the Commission finds that the cost of the new blowers should be capitalized and depreciated over their estimated useful life.

In response to Item 10 of the December 2, 1982, data request, Shady Villa stated that these blowers had a useful life of 2 years in its sewer system. The present condition of the physical plant leads the Commission to concur with Shady Villa as to the estimated useful life of this equipment. Therefore, the Commission has reduced repairs and maintenance expense by \$4,246 for rate-making purposes. In addition, the Commission has increased depreciation expense by \$2,123 to reflect a 2-year useful life.

During the test year Shady Villa purchased a sewage treatment tank at a cost of \$510 and included this amount in operating expenses. Upon an analysis of the expenditure the Commission finds that the purchase should be capitalized and depreciated over its estimated useful life. Therefore, the Commission has reduced repairs and maintenance expense by \$510 for rate-making purposes. In addition the Commission has increased depreciation expense by \$170 to reflect annual depreciation over a 3-year useful life.

### Plant Management Fees

Shady Villa proposed an adjustment to increase its routine maintenance fee from \$450 per month to \$800 per month due to a change in plant operators effective February 1982. Shady Villa maintained it was cheaper to change operators because the costs incurred under the current operator (in excess of the routine monthly fee) were more than it could comfortably bear. Shady Villa further stated that the major difference between the two contracts was that during regular working hours the cleaning or pulling of a pump would not be charged separately by the new operator but would be included as a part of the routine maintenance fee. However, the Commission noted upon review of the invoices submitted in support of the monthly remittances to the routine maintenance companies that the expense for cleaning or pulling of pumps was minimal during the test year and did not support the cost difference between the two operators. The Commission further noted that a significant portion of the expenses shown on the invoices would not be covered under the terms of the new contract, but would be in addition to the regular monthly maintenance fee. Therefore, the Commission finds that Shady Villa has not provided sufficient justification for the increased monthly maintenance fee for rate-making purposes since the duties performed by each operator are virtually the same, and the effect of changing operators on the annual cost of operating the system can not be determined from the evidence in this case.

Therefore, no adjustment has been made herein to increase the annual cost of routine maintenance.

### Board of Health Fees

The test period operating statement reflected \$1,400 in Board of Health fees which were actually incurred during the period 1975-80. The unpaid balances of these recurring fees were carried forward from prior periods and paid during the test year. The actual fee incurred for the test year was \$700. Therefore, the Commission has excluded the Board of Health fees for prior periods of \$1,400.

### Rate Case Expenses

Shady Villa proposed an adjustment of \$2,946 to reflect the 3-year amortization of rate case expenses of \$8,838 incurred for this case. The Commission has reviewed the application and the record established in this matter and is of the opinion that the proposed adjustment for rate case expenses is excessive. The ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases. The Commission is of the opinion that the information requested in this case should have been obtainable with very little outside assistance. Furthermore, the filing of pleadings and documents in this case should not have required the extensive work of attorneys or certified public accountants in the amounts charged for this case. Therefore, the Commission is of the opinion that Shady Villa should be allowed to amortize its actual rate case expenses of \$9,323 over a 5-year period. The 5-year amortization of this expense results in an increase to test year expense of \$1,865.

### Sludge Hauling

Shady Villa proposed an adjustment to increase sludge hauling expense by \$1,978 from \$3,870 to \$5,848. In determining the pro forma level of expense, Shady Villa anticipated that it would haul 24 loads of sludge annually at a cost of \$127 per load and \$2,800 for the partial emptying of one of its sewage tanks. Mr. Frank Wedington, operator of the plant, stated that if 24 loads are hauled annually it would not be necessary to empty the tank. Therefore, the Commission has allowed the proposed 24 loads at \$127 per load and has excluded the proposed \$2,800 for emptying the tank since this cannot be expected to recur. This results in a decrease to test year sludge hauling expense of \$822.

### Collection Charges

Shady Villa projected expenses of \$2,882 related to the collection of its bi-monthly sewer bill by the Louisville Water Company. The adjustment is based on the proposed rate as a percentage of the total sewer and water bill multiplied by the collection charge per bill. The Commission has computed Shady Villa's pro forma collection expense based upon the rate allowed herein. This results in collection expense of \$2,473.

### Electric Expense

Shady Villa proposed an adjustment of \$14,000 to reflect an estimated increase in electric expense as a result of the proposed improvements to its sewer system. The Commission has not allowed the expense associated with the system improvements for rate-making purposes for the reasons discussed in a subsequent section of this Order.

The Commission has adjusted test year electric expense to reflect the current rates in effect from Shady Villa's electric supplier, Louisville Gas and Electric Company, applied to the actual usage by Shady Villa during the test year. This results in an adjusted electric expense of \$12,621 which is \$2,479 greater than the actual test year expense.

System Improvements

Shady Villa proposed an increase of \$19,333 to reflect the 3-year amortization of the estimated cost of \$58,000 for necessary improvements and replacements to its existing sewage treatment plant. A certificate to construct and finance these expenditures has not been requested; therefore, the Commission has not allowed expenses associated with these improvements to be included herein for rate-making purposes. The Commission requests that Shady Villa file an application for approval of construction and financing of these expenditures.

The Commission finds that Shady Villa's adjusted test period operations are as follows:

|                                      | <u>Actual<br/>Test Period</u> | <u>Pro Forma<br/>Adjustments</u> | <u>Adjusted<br/>Test Period</u> |
|--------------------------------------|-------------------------------|----------------------------------|---------------------------------|
| Operating Revenues                   | \$51,290                      | \$2,442                          | \$53,732                        |
| Operating Expenses                   | <u>52,350</u>                 | <u>277</u>                       | <u>52,627</u>                   |
| Operating Income                     | <u>\$ (1,060)</u>             | <u>\$2,165</u>                   | <u>\$ 1,105</u>                 |
| Other Income and<br>(Deductions) Net | <u>(7,318)</u>                | <u>175</u>                       | <u>(7,143)</u>                  |
| Net Income                           | <u><u>\$ (8,378)</u></u>      | <u><u>\$2,340</u></u>            | <u><u>\$ (6,038)</u></u>        |

### REVENUE REQUIREMENTS

Shady Villa based its revenue requirements on a margin requirement of 10 percent of projected annual operating expenses, plus bond principal, interest and operating expenses. Shady Villa presented no evidence in support of this method of determining its revenue requirements. In a note to the financial statements for the test year, Shady Villa's accountants stated that Shady Villa had not complied with its bond resolution as to the placing of the sewer improvement assessment charges in the sinking fund.

Under the provisions of its bond resolution Shady Villa should assess its customers annually for the principal, interest and a coverage of 20 percent of the annual principal and interest payments on the improvement assessment bonds. This assessment is based on the proportion that the assessed value of each parcel of land bears to the total assessed value of benefited lands each year as shown by the assessment records used for county taxation. However, Shady Villa has failed to comply with this provision of its bond resolution. In its proposed rates Shady Villa has requested revenue to recover the principal and interest on the improvement assessment bonds. Shady Villa stated that the basis for not implementing this assessment was that properties were located both inside and outside the legal boundaries that are presently being served. According to the assessment bond ordinance, only benefited properties are to be subject to the assessment. Benefited properties include the land located within the corporate boundaries as described on page 12 of the bond ordinance. Therefore, Shady Villa contends that it would be



unfair to assess only those customers inside the boundaries covered by the bond ordinance.

The Commission is of the opinion that except in extraordinary circumstances Shady Villa should recover the amount to be assessed not through rates but through an assessment as required by its bond resolution. Therefore, Shady Villa should immediately begin to seek implementation of this assessment. However, Shady Villa has not sought implementation of the tax for the 1983 tax year. The earliest period that this tax could be implemented would be in 1984. The tax rate should be submitted to the property assessor's office by June 1 so that the customers could be billed with property tax bills rendered in the fall of 1984. The Commission is of the opinion that Shady Villa should be allowed to recover the amount to be assessed through its sewer rates while implementation of the tax is being accomplished. To do otherwise would adversely affect the financial condition of Shady Villa. The rates in Appendix A will remain in effect until January 1, 1985, at which time Shady Villa should have had sufficient time to collect the amount assessed in the fall of 1984.

Based on the evidence of record herein, the Commission cannot determine a fair and equitable rate, exclusive of the assessment revenue, that should be charged to Shady Villa's customers subsequent to January 1, 1985. At the hearing of May 19, 1983, Shady Villa was required to file a plan of implementation of the assessment which was not provided. Therefore, the Commission finds that Shady Villa should file

within 30 days of the date of this Order pertinent details regarding the customers who reside inside and outside the legal boundaries including the class and usage of each. In addition, Shady Villa should file a detailed analysis of the source of funds and the total construction costs of the original plant in service, the cost of facilities constructed to serve the customers outside the legal boundaries including the source of funds for construction and a breakdown of total contributions in aid of construction as of December 31, 1981.

In determining the revenue requirements in this case, the Commission has used a 1.2X debt service coverage based on the average principal and interest payments required in Shady Villa's bond resolution plus the operating expenses allowed herein. This results in a total revenue requirement of \$72,221 which consists of \$19,594 in revenue which Shady Villa can recover through the special assessment as set out in Section 7 of the assessment bond resolution. Therefore, in order to achieve this level of revenue, Shady Villa should increase its actual revenue produced from rates by \$18,489.

#### OTHER ISSUES

Shady Villa's engineer has estimated that it will cost \$58,000 to perform the repairs and improvements recommended by the Department of Public Health - Louisville and Jefferson County ("DPH"). This work is necessary for Shady Villa to provide adequate and efficient service as required by KRS 278.030. The Commission concurs with the recommendation of DPH based on a site

visit to Shady Villa's sewage treatment plant by Commission engineers.

#### RATE DESIGN

Shady Villa's charges are based on a flat rate design for each class of customer with charges for commercial customers based on a flat rate per residential equivalent. In a flat rate design, the rate includes certain fixed costs in addition to the costs of sewage treatment. For this reason, no downward adjustment is justified in the rate for customers using less than the residential equivalent. Shady Villa has made downward adjustments in charges to commercial customers using less than one residential equivalent, resulting in undercharging of such customers. Shady Villa should charge all commercial customers a minimum bill equal to the rate for one residential equivalent with charges for usage in excess billed per residential equivalent.

#### SUMMARY

The Commission, having considered the evidence of record, and being advised, is of the opinion and finds that:

(1) The rates in Appendix A will produce gross annual operating revenue of \$72,221 and are the fair, just and reasonable rates to be charged in that they will allow Shady Villa to pay its operating expenses and provide a reasonable surplus for equity growth.

(2) The rates proposed by Shady Villa should be denied.

(3) Shady Villa should perform the necessary repairs and improvements in order to provide adequate and efficient service as required by KRS 278.030.

(4) Shady Villa should investigate sources for financing the proposed repairs and improvements and select the best source of financing for its purposes.

(5) Shady Villa should request approval to perform the proposed repairs and improvements based on the following minimum information when available: plans, specifications, bid tabulations and a plan of financing in accordance with finding number 4 herein.

(6) Shady Villa should file within 30 days of the date of this Order a list of the customers who reside inside and outside the legal boundaries as well as the class and usage of each. Shady Villa should provide supporting documents and a map of the system showing the customers inside and outside the legal boundaries. In addition, Shady Villa should file a detailed analysis of the source of funds and the total construction costs of the original plant in service, the cost of facilities constructed to serve the customers outside the legal boundaries including the source of funds for construction and a breakdown of total contributions in aid of construction as of December 31, 1981.

IT IS THEREFORE ORDERED that the rates proposed by Shady Villa be and they hereby are denied.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Shady Villa on and after the date of this Order until January 1, 1985.

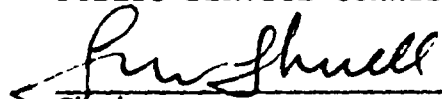
IT IS FURTHER ORDERED that within 30 days of the date of this Order, Shady Villa shall file its revised tariff sheets setting forth the rates approved herein.

IT IS FURTHER ORDERED that Shady Villa shall file its application with this Commission in accordance with finding number 3 herein for approval to perform the proposed repairs and improvements and for approval of its plan of financing within 60 days prior to entering into any construction contracts.

IT IS FURTHER ORDERED that Shady Villa shall file within 30 days of the date of this Order a list of the customers who reside inside and outside the legal boundaries as well as the class and usage of each. Shady Villa shall provide supporting documents and a map of the system showing the customers inside and outside the legal boundaries. Further, Shady Villa shall file a detailed analysis of the source of funds and the total construction costs of the original plant in service, the cost of facilities constructed to serve the customers outside the legal boundaries including the source of funds for construction and a breakdown of total contributions in aid of construction as of December 31, 1981.

Done at Frankfort, Kentucky, this 25th day of August, 1983.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

\_\_\_\_\_  
Secretary

## APPENDIX A

### APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NOS. 8717 AND 8816 DATED AUGUST 25, 1983

The following rates are prescribed for the customers in the area served by Shady Villa Sewer Construction District located in Jefferson County, Kentucky. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

| <u>Customer Category</u>   | <u>Monthly Rates</u> |
|----------------------------|----------------------|
| Single Family Residential  | \$9.20               |
| One Bedroom Apartment      | 6.45                 |
| Two Bedroom Apartment      | 6.90                 |
| Commercial                 |                      |
| per residential equivalent | 9.20                 |
| (7,020 gallons per month)  |                      |